# HOUSE BUDGET COMMITTEE

## Democratic Caucus

**The Honorable John M. Spratt Jr. ■ Ranking Democratic Member**

214 O'Neill HOB ■ Washington, DC 20515 ■ 202-226-7200 ■ www.house.gov/budget_democrats

November 29, 2001

## WHAT HAPPENED TO THE SURPLUS?

Dear Democratic Colleague:

Yesterday, President Bush claimed that his Administration had "brought sorely needed fiscal discipline to Washington." On the same day, OMB Director Mitchell Daniels warned the country not to expect another budget surplus until 2005 — after President Bush's term of office is up. The unified budget surplus of $304 billion projected for FY 2002, and the cumulative surplus of $5.629 trillion projected over ten years, which this Administration inherited, are gone. Director Daniels blamed the economy and the fight against terrorism, and absolved the President's tax cuts. In fact, last June's tax cut is most responsible for wiping out the surplus, and the Republican stimulus plan, with further permanent tax cuts, would only dig the hole deeper.

As the attached House Budget Committee Democratic staff analysis shows, the tax cut contributed more than half — 54.7 percent — to the depletion of the surplus, based on the bipartisan, bicameral estimates of the Budget Committee staffs.

Furthermore, the budget situation is far more ominous than today's estimated ten-year surplus of $2.604 trillion would suggest. On net, virtually all of that surplus comes from the Social Security Trust Fund surplus, and is concentrated in the distant future years, where the outlook is most uncertain. And that projected surplus will surely be cut significantly by next January's economic and budget outlook revisions.

These events and estimates prove even more that the tax cut was irresponsible. It made the budget more vulnerable to unforeseen crises, economic misfortune, and ultimately the burdens of baby boomers' retirement. At the least, the Bush Administration should heed this lesson and not compound its mistake.

I hope you will find this report informative and useful, particularly in light of the President's claims and Director Daniels' revelations. If you have questions, feel free to contact me at 225-5501 or the Budget Committee staff at 226-7200.

Sincerely.
John M. Spratt, Jr.
Ranking Democratic Member

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# THE DISSIPATION OF THE BUDGET SURPLUS, 2001


**Executive Summary**

1. On November 28, 2001, President Bush claimed that his Administration "brought sorely needed fiscal discipline to Washington." On the same day, OMB Director Mitchell Daniels warned the country not to expect another budget surplus until 2005 — after President Bush's term of office is up. The unified budget surplus of $304 billion projected for FY 2002, and the cumulative surplus of $5.629 trillion projected over ten years, which this Administration inherited, are gone. Director Daniels blamed the economy and the fight against terrorism, and absolved the President's tax cuts. In fact, last June's tax cut is most responsible for wiping out the surplus, and the Republican stimulus plan, with further permanent tax cuts, would only dig the hole deeper.

2. The Republican tax cut contributed more than half — 54.7 percent — of this worsening of the surplus, based on the bipartisan, bicameral estimates of the Budget Committee staffs.

3. The worsening of the economy, which began well before September 11, has had a significant impact in the near term (2001 to 2003). But, beyond those next few years, the effect of the economy fades as recovery takes hold. The role of increased spending — to counter terrorism and to address other priorities — is not significant.

4. On net, virtually all of today's estimated cumulative ten-year surplus of $2.604 trillion comes from the Social Security Trust Fund surplus, and is concentrated in the future years, where the outlook is most uncertain.

5. These events and estimates prove even more that the tax cut was irresponsible. It made the budget more vulnerable to unforeseen crises, economic misfortune, and ultimately the burdens of the baby boomers' retirement.

## THE DISSIPATION OF THE BUDGET SURPLUS, 2001

> …we brought sorely needed fiscal discipline to Washington, D.C. … we fought for and got a budget that was realistic, that didn't grow way beyond the means of our government.
>
> President George Bush
> November 28, 2001

> …it is regrettably my conclusion that we are unlikely to return to balance in the federal accounts before possibly fiscal '05.
>
> OMB Director Mitchell Daniels
> November 28, 2001

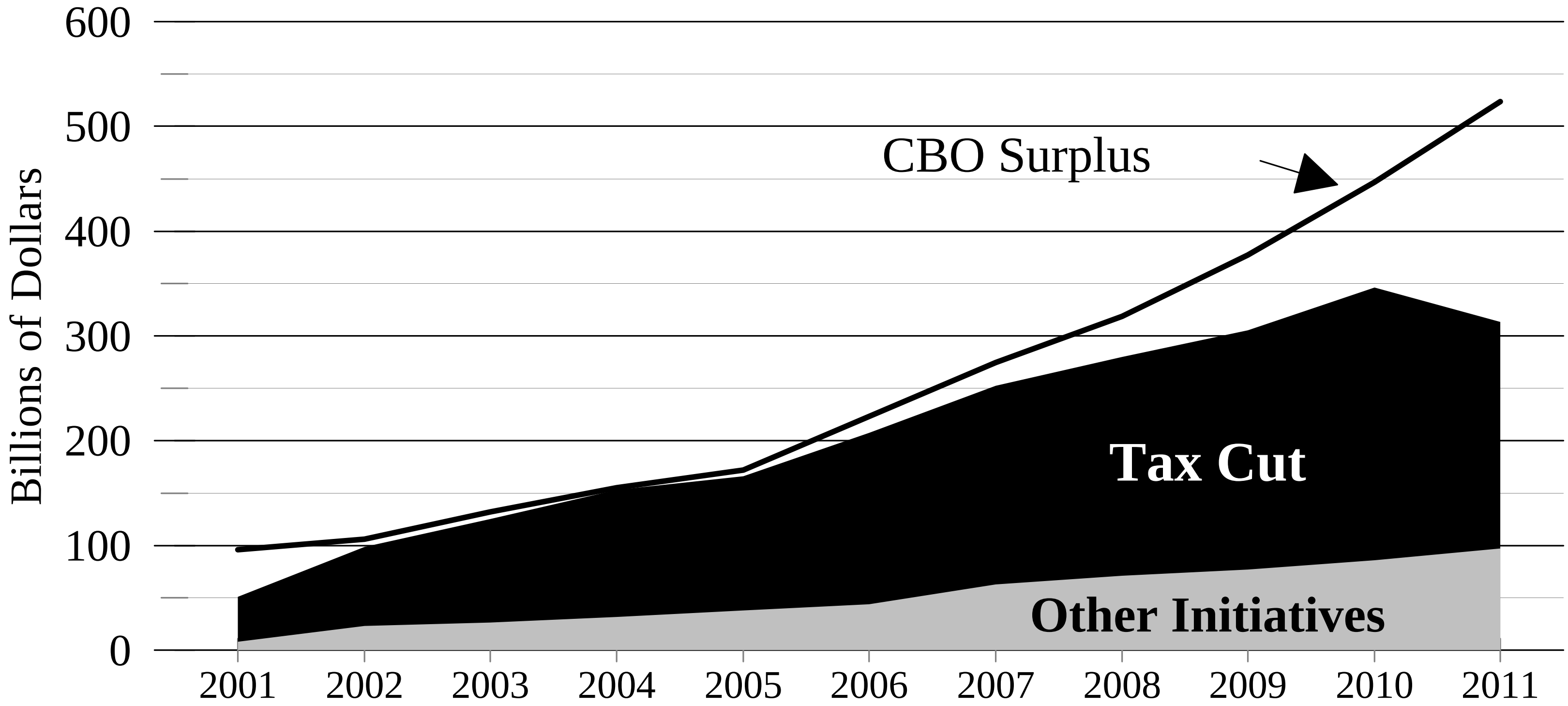
OMB Director Mitchell Daniels has warned the country not to expect another budget surplus until 2005 — after President George Bush's term of office is up. Director Daniels blamed the economy and the fight against terrorism; he absolved the President's tax cuts. In fact, the Administration advocates further permanent tax cuts in its economic stimulus plan. The Administration's June tax cut wiped out most of the surplus and now they want to dig the hole deeper.

From May to October of this year — a period of five months — the projected 2002 unified budget surplus of $304 billion disappeared, and the ten-year projected surplus dropped from $5.629 trillion to $2.604 trillion. More bad news is sure to come with the economic and budget updates next January. Furthermore, on net, all of today's estimated cumulative ten-year surplus of $2.604 trillion comes from the Social Security and Medicare Trust Fund surpluses. What little surplus remains is concentrated in the future years, where the outlook is most uncertain.

How did this happen? Economic cycles and the terrorist attacks surely contributed. But there is no doubt that the greatest part of this fiscal injury was self-inflicted — through an excessive tax cut.

After the Congressional Budget Office (CBO) significantly increased its projections of the budget surpluses over the ten-year horizon at the beginning of this year, the Administration and Congressional Republicans proceeded to commit virtually every scrap of the projected surplus that they could to the tax cut. The Congress passed, and the President signed, a $1.346 trillion tax cut over the eleven fiscal years 2001-2011. With an additional $0.386 trillion due to increased debt service, the total budgetary hit from the tax cut comes to $1.732 trillion. As shown in the attached chart, the cost of the tax cut was carefully shaped to come as close as possible to exhausting the entire projected non-Social Security, non-Medicare surplus through 2007, with next to zero margin for error. Over ten years, the tax cut did

# THE TAX CUT SHAVED THE PROJECTED SURPLUS TO THE BONE




CBO's August Projected Non-Social Security, Non-Medicare Surplus leave an ostensible "reserve" of about $500 billion; but the vast bulk of that sum, 86 percent, arose in the last five years — at which time budget projections are most uncertain.

What is even more disturbing, the Congressional Republicans, supported by the White House, pursued their tax cut to the exclusion of all other priorities, including a prudent and responsible budget reserve. In his budget address to the Congress in February, the President emphasized that he would address the programmatic needs of the government, pay down the debt, "[a]nd then, when money is still left over," provide a tax cut. But on the contrary, what the White House and the Congressional Republicans in fact did was to pass the tax cut *first*—before retiring debt, before even submitting a defense budget, before passing a farm bill, before providing Medicare prescription drug coverage, and so on. Now, well after the beginning of the next fiscal year, most of these other priorities have not been addressed, much less fulfilled, and the surplus is gone.

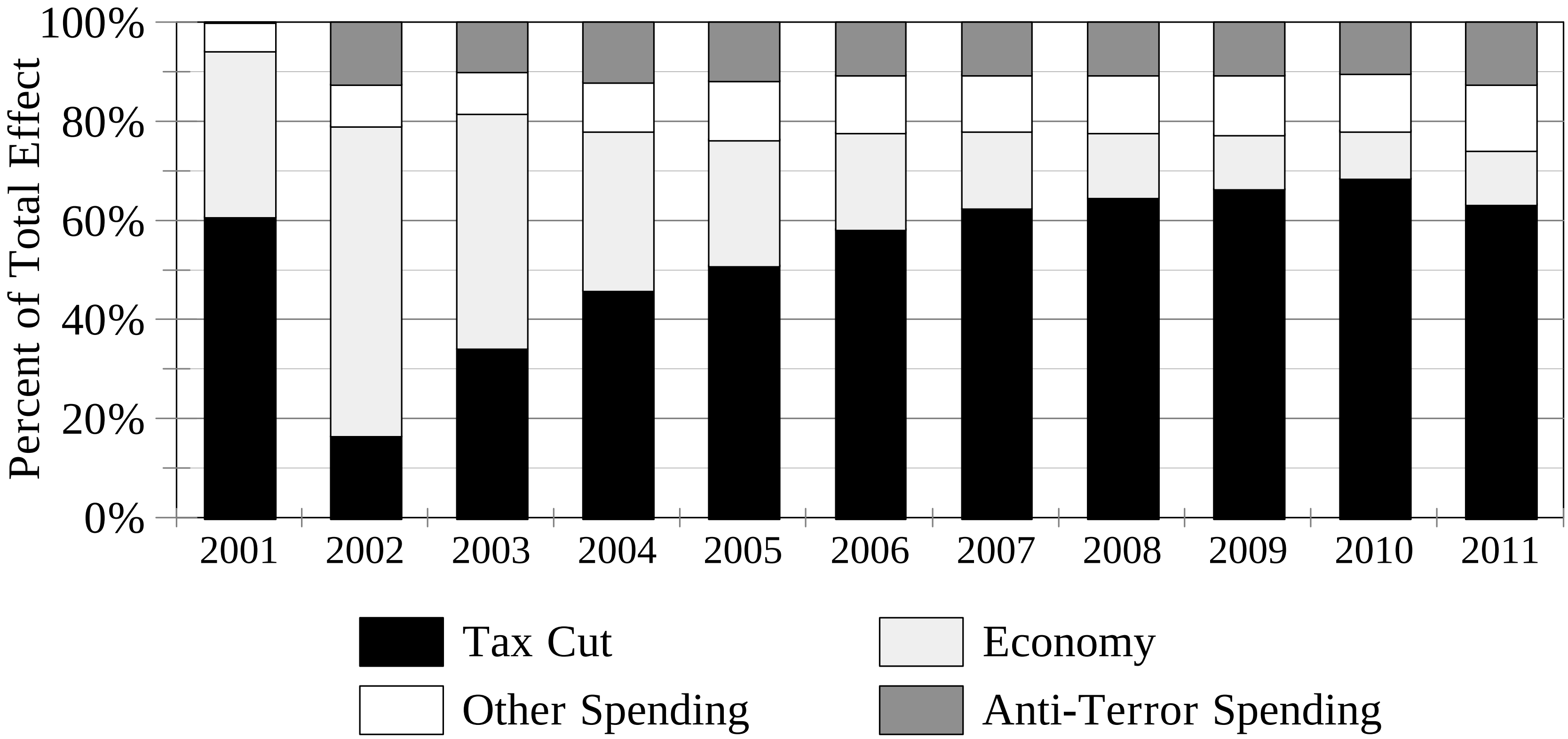
Subsequent developments have demonstrated clearly just how imprudent this tax cut was. First, the Administration, which had been talking down the economy since early December of 2000 to sell its tax cut, saw the economy deteriorate in a self-fulfilling prophecy. And since September 11, the economy has slumped even further, while the unavoidable costs of terror-fighting and war have mounted.

Because of the further slowing of the economy (and associated technical factors), economists of the House and Senate Budget Committee staffs have estimated, on a bipartisan basis, that the surpluses in 2002 through 2004 will be reduced by $80 billion, $56 billion, and $8 billion (exclusive of net interest) respectively. These revisions are in addition to the reestimates CBO already had made in August.

The President and the Congress have provided $40 billion in additional funding to deal with the damage and the security threats, half of which is assumed to recur in future years. Congress appropriated $5 billion in cash assistance for the airline industry, backed $15 billion in loan guarantees, and provided the airlines with relief from liability for the disaster as well. The President's $18 billion defense budget amendment to his original placeholder request has been built into the appropriations process, and further additions for defense appear inevitable. Again, on a bipartisan, bicameral basis, the staffs of the two Budget Committees have concluded that the total costs of these initiatives, plus debt service (on these programs plus the economic reestimates) will reduce the surplus by $124 billion in 2002, and by $793 billion over 2002-2011. And these estimates ignore the stimulus bill that is making its way through the Congress, and other unaddressed priorities such as the farm bill, education, expiring tax provisions, and the ballooning individual alternative minimum tax.

The bipartisan, bicameral estimates of the Budget Committee staffs, illustrated in the second attached chart, lead to the following conclusions:

# The Tax Cut Did The Most To Worsen The Budget



The President's enacted tax cut remains by far the largest single contributor to the deterioration of the budget outlook over the next ten years. Not including the stimulus bill or any other pending tax initiatives, the tax cut contributed more than half — 54.7 percent — to the depletion of the surplus over the ten years 2002-2011.

The worsening of the economy (including technical reestimates) has had a significant impact in the near term (2001 to 2003 or so). Economic and technical factors dominate the figures (62.8 percent) in 2002. However, beyond those next few years, the effect of the economy fades as recovery is projected to take hold. For the last five years of the budget window, the share of the tax cut in the total worsening is over 60 percent — even assuming that all of the tax provisions will sunset at the end of 2010.

The impact of increased spending unrelated to the terrorist attack is small, averaging only 11.1 percent over the ten-year budget window. (For purposes of this analysis, all of the ten-year consequences of the President's request for $18 billion per year of additional defense spending are included in this non-terror-related category.) Clearly, the effect of terrorism on the spending side of the budget is far from certain at this time. However, the bipartisan Budget Committee estimates suggest that the cost of recent and likely imminent action will be a small piece of the overall puzzle. Estimated anti-terror spending averages 11.0 percent of the worsening of the surplus over the ten years. (The impact of spending is projected to take a small jump in 2011, if the tax cut actually sunsets at the beginning of that year.)

Although today's estimated cumulative ten-year surplus remains as large as $2.604 trillion, that figure is not comforting on closer examination. At the beginning of this year, the bipartisan goal in the Congress was to reserve the entire Social Security and Medicare Trust Fund surpluses, which were estimated in August to total $2.955 trillion ($2.551 trillion for Social Security, and $0.404 trillion for Medicare). Thus, the remaining projected unified surplus, on net over ten years, comes totally from those Trust Fund surpluses. The surplus that remains is still concentrated in future years, and even that surplus is likely to be eroded by the new economic and budget projections in January.

The deterioration of the surplus because of the weakening of the economy and the costs of resisting terrorism does not absolve the tax cut. Any future economic weakness, and any added costs for fighting terrorism, will reduce the percentage of the total surplus deterioration that is directly due to the tax cut; and the reduction of that percentage might lead some to conclude that the tax cut is less at fault for the worsening budget. Taken to its extreme, this argument would say that the worse the budget gets, the less bad an idea the tax cut was.

But in a broader sense, such an argument misses a more important point: recent events prove even more that the tax cut was unwise. A central element in leadership and stewardship is to be prudent, to be prepared for adverse contingencies. It is not good stewardship to choose policies that make the budget more vulnerable — to tragedies, to economic misfortune, or ultimately to the burdens of the baby boomers' retirement.

The budget is almost certain to revert to unified deficit in 2002, and quite possibly in 2003 and 2004 as well. The direction for subsequent years is heavily dependent upon the state of the economy. But the Republican tax cut played a central role in these developments. This fact should serve as a cautionary flag to the Administration and Congressional Republicans who are now promoting a second tax cut which will dig the hole even deeper — a fact which should inform future policy choices, lest budget outcomes prove even worse.